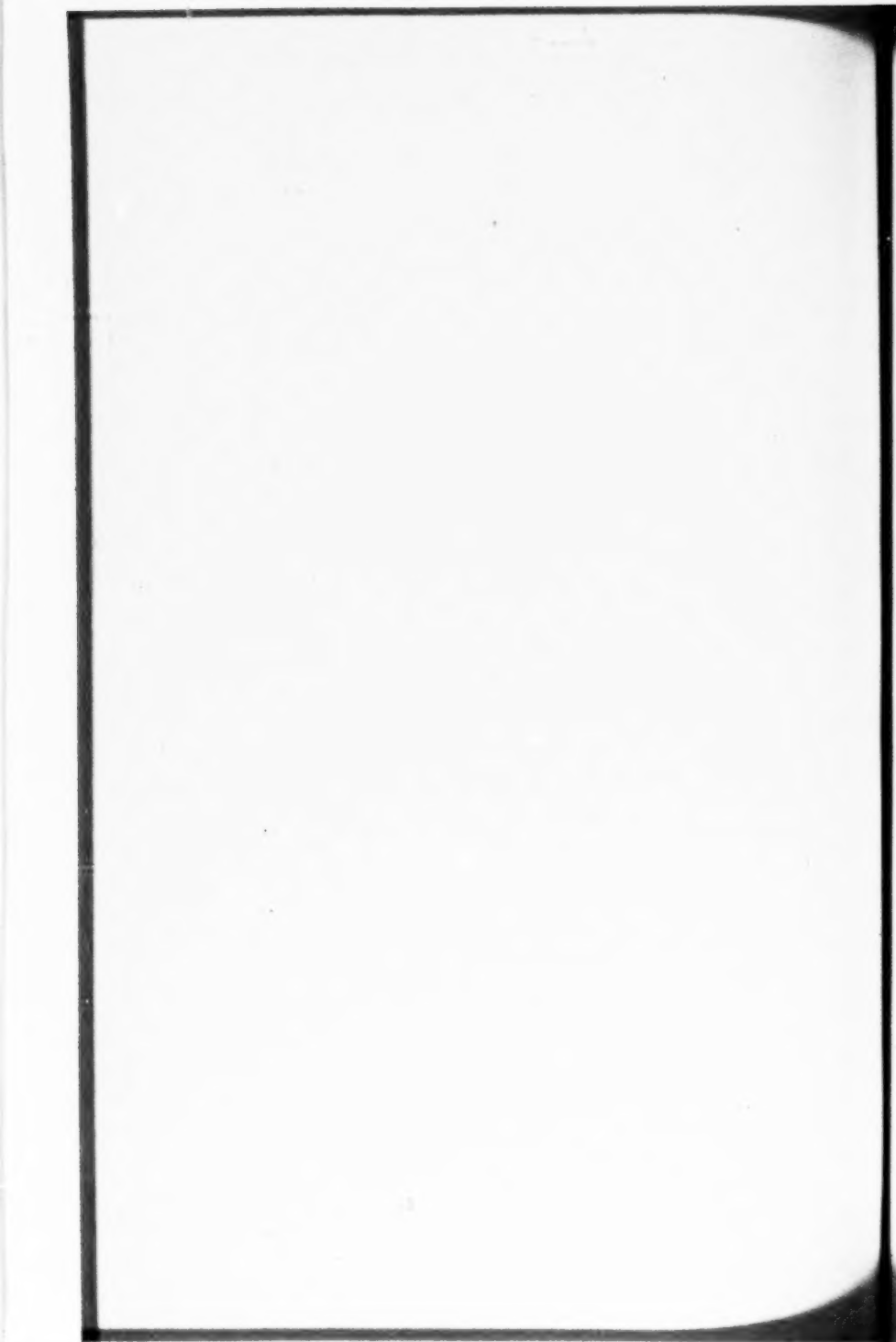


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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 421

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

NORBERT H. WIESLER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH
CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari be issued to review the judgment of the Circuit Court of Appeals for the Sixth Circuit entered in this case.

OPINIONS BELOW

The opinion of the Tax Court (R. 35-49) is reported in 6 T. C. 1148, and the opinion of the Circuit Court of Appeals (R. 65-70) is reported in 161 F. 2d 997.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 3, 1947. (R. 65.) A motion for an extension of time until November 2, 1947, to file this petition was granted by Mr.

Justice Jackson on August 26, 1947. (R. 70.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether review of the Tax Court's decision by the court below is restricted by *Dobson v. Commissioner*.

2. Whether amounts paid in lieu of dividends on borrowed stock used to cover short sales are deductible as business expenses under Section 23 (a) of the Revenue Acts of 1936 and 1938 and of the Internal Revenue Code, or are, in accordance with Treasury practice of long standing, capital items constituting part of the cost basis of the shares purchased to reimburse the lender.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are printed in the Appendix, *infra*, pp. 8-12.

STATEMENT

The facts as stipulated and as found by the Tax Court (R. 36-43) may be summarized as follows:

Taxpayer, an individual, opened several accounts with a stock brokerage firm. One of these accounts, Account No. 2, was used exclusively for making short sales of General Motors common stock. Another account, designated Collateral Account, was opened for the purpose of depositing securities as collateral for tax-

payer's No. 2 account and other accounts. When the Collateral Account was opened in 1932, taxpayer made an initial deposit therein of 10,000 shares of General Motors common stock. These securities were not used to cover short sales in Account No. 2, but only as collateral for such sales and for other accounts. (R. 36-37.)

In accordance with established brokerage practice, taxpayer's brokers credited to taxpayer in the Collateral Account the dividends payable on shares in that account in which taxpayer was long on dividend dates. The brokers likewise charged to taxpayer in Account No. 2, the dividends payable on shares in that account in which the taxpayer was short on dividend dates. During the four taxable years in issue, dividends credited to taxpayer in the Collateral Account amounted to between \$58,542.50 and \$78,322.50 annually; dividends charged against Account No. 2 amounted to between \$55,250 and \$76,725 annually. (R. 38.)

In his income tax returns for the years 1936 and 1937 taxpayer offset the dividends charged against him in Account No. 2, against the dividends credited to him in the Collateral Account, and reported as dividend income in each year only the excess of the dividends credited in the Collateral Account over the dividends charged in Account No. 2. In his returns for 1939 and 1940 he reported as dividend income the amount of the dividends credited to him in his Collateral

Account for each year, and he claimed as deductions against gross income in the returns for 1939 and 1940 the dividends charged against him in those years, respectively, in Account No. 2. The Commissioner in his determination of a deficiency considered the dividends credited to taxpayer in the Collateral Account as taxable income to him and disallowed as offsets or deductions the dividends charged against him in Account No. 2 for each of the years 1936, 1937, 1939, and 1940. (R. 38.)

The taxpayer's trading activities were substantial during the four taxable years, although there was a marked decrease in activity starting in 1938 as a result of a decline in market values of securities and stricter margin requirements imposed by Regulation T of the Board of Governors of the Federal Reserve System. (R. 39.)

From 1932 until November 1, 1937, taxpayer engaged in no other business activities aside from his trading in stock. After November 1, 1937, and until January 1, 1938, taxpayer was employed by the National Bank of Detroit. On the latter date and throughout the taxable years taxpayer was employed by the Wabeek State Bank of Detroit. Taxpayer reported in his returns as annual salary received by him from these banks from 1937 to 1940 amounts varying from \$350 to \$2,812.50. (R. 39.)

Taxpayer during the taxable years was engaged

in the business of trading in securities. (R. 39-40.)

The Tax Court held that the taxpayer was engaged in the business of stock trading, and that the dividends charged to Account No. 2 in connection with taxpayer's short sales were deductible as business expenses. (R. 43-45.) The Circuit Court of Appeals for the Sixth Circuit ruled that the case was governed by *Dobson v. Commissioner*, 320 U. S. 489, and affirmed with one judge concurring in the result.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the rule of *Dobson v. Commissioner* restricts the review of the Tax Court's decision in this case.
2. In failing to hold that amounts paid in lieu of dividends on stock borrowed to cover short sales are not deductible as ordinary and necessary expenses under Section 23 (a) of the Revenue Acts of 1936 and 1938 and of the Internal Revenue Code.
3. In failing to hold that amounts paid in lieu of dividends on stock borrowed to cover short sales constitute a part of the cost basis of the shares subsequently purchased to reimburse the lender.
4. In affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT

1. This case involves the same issues as *Commissioner v. F. A. Wilson*, No. 420, in which a petition for a writ of certiorari is now being filed.

The *Wilson* case presents a direct conflict on the merits with decisions of two other Circuit Courts of Appeals. The court below failed to decide this case on the merits since it held *Dobson v. Commissioner*, 320 U. S. 489, to be controlling and restrictive of its review. For the reasons given in our *Wilson* petition we believe the decision below to be erroneous in this respect.

2. Although the court below relied on the *Dobson* case, it did discuss the merits of the case at some length and indicated its position as follows (R. 68):

The charges in the present case were not incurred as an incident either to the acquisition or sale of the property involved, but are more in the nature of carrying charges incurred during the progress of the deal between the time of sale and the time of purchase. They closely resemble such charges as interest on borrowed money and safety storage charges in holding securities when a "long" transaction is involved, which have been recognized as expenses of doing business. While what the short seller pays is not technically interest, yet it is an expense necessary to his obtaining and using the stock. * * *

Since this view accords with that of the Ninth Circuit in the *Wilson* case it is submitted that, for the reasons presented in our petition in that case, this, too, is an appropriate one for this Court to resolve the conflicting views among the circuits.

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

PHILIP B. PERLMAN,
Solicitor General.

OCTOBER 1947.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121 (a) and (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses*.—

(1) *Trade or business expenses*.—

(A) *In general*.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(2) *Non-trade or non-business expenses*.—In the case of an individual all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(g) *Capital Losses*.—

(1) *Limitation*.—Losses from sales or exchanges of capital assets shall be allowed

only to the extent provided in section 117.
(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property;
* * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;
* * *

(26 U. S. C. 1940 ed., Sec. 113.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(g) *Gains and Losses From Short Sales, Etc.*—For the purpose of this chapter—

(1) gains or losses from short sales of property shall be considered as gains or losses from sales or exchanges of capital assets;
* * *

(26 U. S. C. 1940 ed., Sec. 117.)

The Code provisions set forth above are applicable to tax years 1939 and 1940. Sections 23 (a) and (j), 113 (a) and (b) (1) (A) and 117 (e) (1) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, and Sections 23 (a) (1) and (g) (1), 113 (a) and (b) (1) (A) and 117 (g) (1) of the Revenue Act of 1938, c. 289, 52 Stat. 447, are similar and are not repeated. Section 23 (a) (2), Internal Revenue Code, was added to the Code by Section 121 of the Revenue Act of 1942 and was made retroactive to tax years beginning after December 31, 1938.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-1 [as amended by T. D. 5166, 1942-2 Cum. Bull. 87]. *Business Expenses*.—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23 (b) to 23 (s), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. As to charitable contributions by corporations not deductible under section 23 (a), see section 19.23 (a)-13. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See section 19.22 (a)-5.) Among the items included in business expenses are management expenses, commissions (but see section 19.24-2), labor, supplies, in-

cidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 19.23 (a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provision of section 23, see section 24.

SEC. 19.23 (a)-15 [as added by T. D. 5196, 1942-2 Cum. Bull. 96]. *Nontrade or Nonbusiness Expenses*.—(a) *In general*.—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, as amended, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

* * * * *

SEC. 19.117-6 [as amended by T. D. 5217, 1943 Cum. Bull. 314, 326-7]. *Gains and Losses From Short Sales*.—For income tax purposes, a short sale is not deemed to be consummated until delivery of property to cover the short sale, and the percentage of the recognized gain or loss to be taken into account under section 117 (b) from a short sale shall be computed according to the period for which the property so delivered was held. Thus, if a taxpayer made a short sale of shares of stock and covered the short sale by purchasing and delivering shares which he held for not more than six months, 100 percent of the recognized gain or loss would be taken into account under section 117 (b), even though he had on hand other shares of the same stock which he held for more than six months. If the short sale is made through a broker and the broker borrows property to make delivery, the short sale is not deemed to be consummated until the obligation of the seller created by the short sale is finally discharged by delivery of property to the broker to replace the property borrowed by the broker.

Insofar as pertinent to the instant case, Articles 23 (a)-1 and 117-6 of Treasury Regulations 94, applicable under the Revenue Act of 1936, and of Treasury Regulations 101, applicable under the Revenue Act of 1938, are similar to the foregoing provisions and are not repeated.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

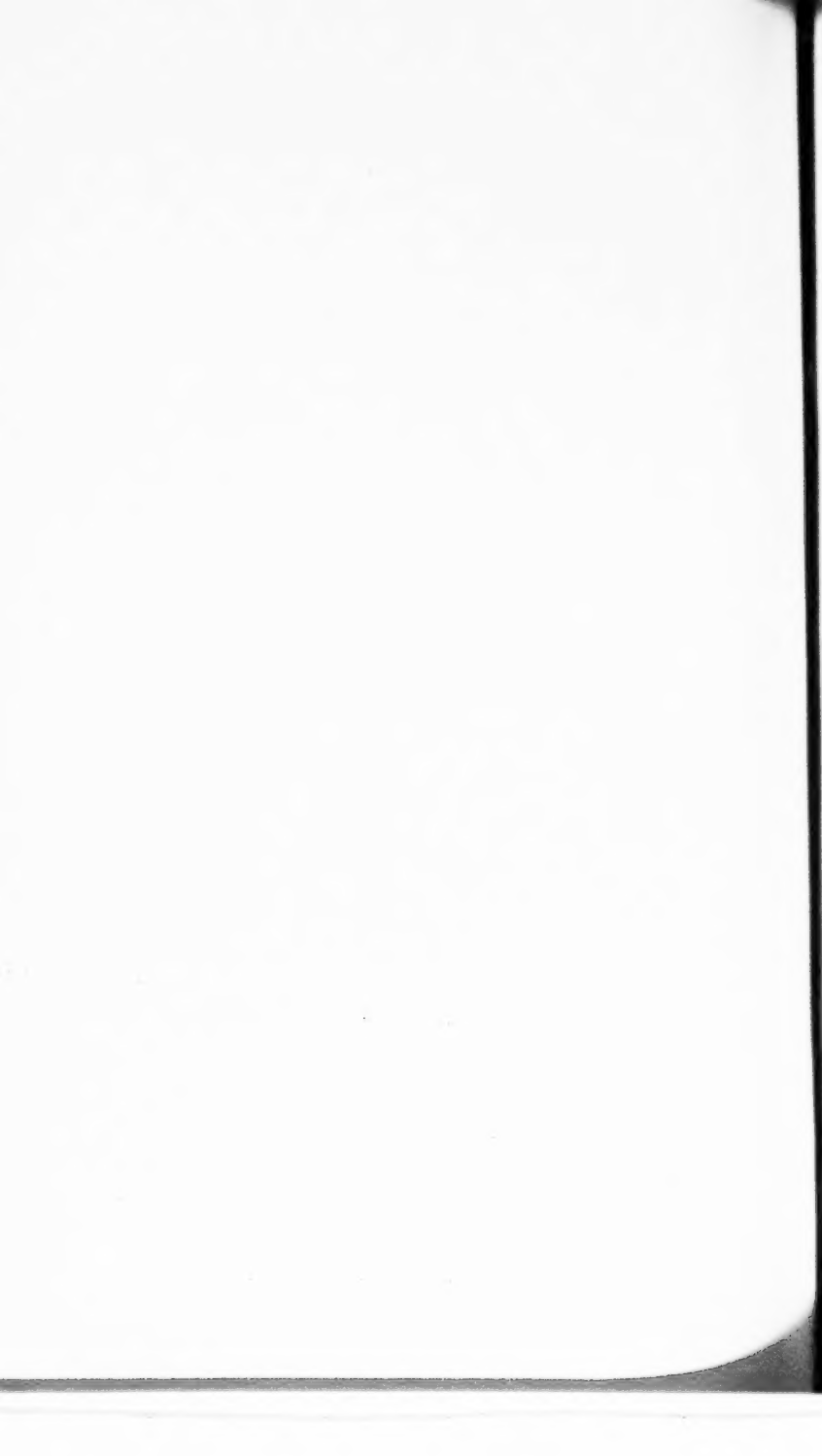
NORBERT H. WIESLER

BRIEF IN OPPOSITION TO PETITION FOR A WRIT
OF CERTIORARI TO THE UNITED STATES
CIRCUIT COURT OF APPEALS FOR
THE SIXTH CIRCUIT

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1947

No. 421

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

NORBERT H. WIESLER

**BRIEF IN OPPOSITION TO PETITION FOR
WRIT OF CERTIORARI**

This brief is filed by Norbert H. Wiesler in opposition to the Petition for a Writ of Certiorari which has been filed in this Court by the Commissioner of Internal Revenue. The parties will hereinafter be referred to as "Commissioner" and "Wiesler".

QUESTIONS PRESENTED

We believe that with respect to the real issue presented—as distinguished from the application of the rule of *Dobson v. Commissioner*—the Commissioner has not

correctly stated the question, and we have accordingly restated the questions presented as follows:

1. Whether review of the Tax Court's decision is restricted by *Dobson v. Commissioner*, 320 U.S. 489.
2. Whether, in the absence of a governing Treasury regulation, the Tax Court correctly decided that a taxpayer engaged in the business of trading in securities is entitled to deduct as business expenses amounts paid by him in lieu of dividends on borrowed stock used to cover short sales, under Section 23 (a) of the Revenue Acts of 1936 and 1938 and of the Internal Revenue Code.

STATEMENT OF THE CASE

We accept the Statement of Facts in the petition (pp. 2-5).

INTRODUCTORY STATEMENT

In the petition herein the Commissioner informs the Court that he relies on the reasons presented in his petition for a writ to the Ninth Circuit in the case of *Commissioner v. F. A. Wilson*, No. 420, filed on the same date.

In the *Wilson* case the Circuit Court ruled directly on the merits, holding that the questioned payments were deductible as business expenses, and also held that a review of the Tax Court's decision was restricted by the

Dobson case. In the *Wiesler* case the Circuit Court, although indicating clearly its agreement with the Tax Court's conclusion (Pet. p. 6), rested its decision on the ground that the Tax Court's decision should be affirmed on the basis of the *Dobson* case.

We are informed that counsel for the taxpayer in the *Wilson* case is not filing a brief in opposition to the petition for a writ. For that reason, and since the questions presented by the two cases are identical, we ask that this brief be considered by the Court in its action on both petitions.

REASONS FOR DENYING THE WRIT

1. The Court below correctly affirmed the Tax Court on the authority of *Dobson v. Commissioner*.

The Commissioner argues against the application of the *Dobson* case on the grounds that the decisions of the Tax Court in these cases provide "a rule of general applicability", and that the Circuit Court's conclusions as to the application of *Dobson* conflict with the rationale of certain later decisions by this Court (*Wilson* Petition, p. 6). The rule prescribed by the decisions in these cases has no more "general applicability" than does the rule prescribed in the *Dobson* case. That the *Dobson* case involves a rule of general applicability is demonstrated by the numerous cases decided on the basis of the tax benefit rule, in which the Tax Court's decision in *Dobson v. Commissioner*, 46 B.T.A. 770, is cited as authority. See, e.g., *John R. Gibson, Jr.*, T. C. Memo.

Op., 12/31/43, P-H Para. 43,530; *Estate of Harriet Ankeny*, T. C. Memo. Op., 2/25/44, P-H Para. 44,052; *W. T. Morris*, T. C. Memo. Op., 1/3/44, P-H Para. 44,001. Thus, if the Commissioner would exclude cases involving a rule of "general applicability" from the ambit of *Dobson*, logically he must exclude the *Dobson* case, itself!

The questions presented in the three cases are not fundamentally different. The question in *Dobson* was whether certain receipts represented taxable income or a return of capital, and in these cases the question is whether certain expenditures are deductible expenses or capital in nature. Since the former was held by the Supreme Court in *Dobson v. Commissioner*, supra, to be "only a question of proper tax accounting", hence not subject to review, it would follow that the question obtaining in the instant cases would also be a question of proper tax accounting, likewise not subject to review.

The cases cited by the Commissioner in the petition in No. 420 (p. 6) in which this Court reviewed decisions of the Tax Court are clearly distinguishable. In *Trust of Bingham v. Commissioner*, 325 U.S. 365, and *Craue v. Commissioner*, 331 U.S. 1, the question turned on the meaning of specific words found in the statute. In *McWilliams v. Commissioner*, 331 U.S. 694, the question was whether a certain section of the statute, limiting the deductibility of losses, applied to the taxpayer's sale of securities. In *John Kelly Company v. Commissioner*, 325 U.S. 365, this Court reversed the Court of Appeals and affirmed the Tax Court on the authority of *Dobson*.

2. The case was correctly decided below.

There has never been a Treasury regulation governing the treatment for tax purposes of the payments here involved, as was the case in *Helvering v. Winnill*, 305 U.S. 79, and *Spreckels v. Helvering*, 315 U.S. 626. The Commissioner, however, says that the decision below reverses "a long established administrative practice which has consistently required that these substituted dividend payments be added to the cost basis of the covering securities." We challenge the correctness of that statement. Wiesler's tax history demonstrates its incorrectness. In a proceeding involving his taxes for earlier years (42 B.T.A. 1477, P-H B.T.A. Memo. Dec. Para. 40,379, July 17, 1940) Wiesler had deducted identical payments as business expenses. Although his gain or loss on short dealings in stock were in issue, the Commissioner in that proceeding did not question his right to deduct as business expenses his payments equivalent to dividends on borrowed stock. It seems apparent that following the decision in *Dart v. Commissioner*, 74 F (2d) 845 (1935), the Commissioner abandoned his prior administrative practice and resurrected it only after the decision in *Helvering v. Wilmington Trust Company*, 124 F (2d) 156 (1941).

There is no valid analogy between payments on borrowed stock and purchase and selling commissions such as were involved in *Helvering v. Winnill*, *supra*, and *Spreckels v. Helvering*, *supra*. The payments involved here represent carrying charges and closely resemble

the payment of interest on a business loan which is clearly deductible under Section 23 (a). In *Deputy v. DuPont*, 308 U.S. 488 (1940), this Court, while denying DuPont the right to deduct such payments as business expenses, rested its decision on the fact that the payments were not related to any trade or business carried on by DuPont. In distinguishing *Dart v. Commissioner* this Court said "Thus, it has been held that one who is an active trader in securities might take as deductions *carrying charges* on short sales since selling short was common in that business." (Italics supplied.)

We submit that the question was correctly decided below on the merits, and that the Circuit Court in the *Wilson* case reached the correct result. The correctness of its decision is clearly demonstrated by the following excerpt from its opinion (Rec. No. 420, p. 73):

"A 'short' sale of stock, such as we have in the present case, entails a *borrower* and a *lender* of stock, the borrower being the debtor to the lender. As heretofore stated, for any period during which the shares borrowed by the short dealer have not been replaced with the lender, the contract provides that the lender must be reimbursed in an amount equivalent to the dividends declared on the stock loaned while the lender is out of possession. See *Provost v. United States*, 269 U.S. 443, 450, 452, *supra*.

"Here the payments under discussion, which were made by the borrower to the lender, reflect amounts representing the equivalent of the dividends declared on the borrowed stock, during the time that the borrowed shares were not replaced. This closely resembles the payment of interest on a business loan which has been held to be deduct-

ible under Section 23 (a) Internal Revenue Code, *supra*, as a business expense.

"It has been said that the designation as 'interest' of an amount paid or accrued during the taxable year is contingent upon its having some relationship to indebtedness. Commissioner of Internal Revenue v. Park, 38 B.T.A. 1118, *aff'd*. 113 F (2d) 352. 'Indebtedness' as used in the revenue acts has been defined as something owed in money which one is unconditionally obligated or bound to pay, the payment of which is enforceable. *Gilman v. Commissioner*, 18 B.T.A. 1277, *affirmed* 8 Cir., 53 F (2d) 47, 80 A.L.R. 209. The payment of the dividend here represents a sum of money unconditionally owed by the borrower to the lender of stock; it arises out of the relationship of debtor and creditor and is a customary expense in a 'short' sale incident to obtaining and using the stock. It is ordinary and necessary in this type of transaction."

3. There is no real conflict below requiring review by this Court.

The *Wilmington Trust Company* and *Levis Estate* cases were both decided before the decision of this court in the *Dobson* case. Since the rule of *Dobson* is applicable to this case, the conflict among the circuit courts is more apparent than real. The decision of the Circuit Court in *Helvering v. Wilmington Trust Co.*, *supra*, does not serve as a precedent since it was reversed on other grounds by this court. The continued adherence of the Tax Court to its views on the issue shows independent exercise of its judgment and demonstrates that there is a rational basis for its conclusions. The most that can be said is that

there is a reasonable difference in legal opinion respecting the correct income tax treatment of the questioned payments. Since the decision by the Court of Appeals for the Second Circuit in the *Levis Estate* case, that court has taken the position that such a reasonable difference in legal opinion is to be resolved in subsequent cases in favor of the ruling of the Tax Court. *Brooklyn National Corporation v. Commissioner*, 157 F (2d) 450, 452.

CONCLUSION

For the foregoing reasons the Petition for a Writ of Certiorari should be denied.

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